STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

SBC COMMUNICATIONS INC.,
SBC DELAWARE INC.
AMERITECH CORPORATION,
ILLINOIS BELL TELEPHONE COMPANY
d/b/a AMERITECH ILLINOIS, and
AMERITECH ILLINOIS METRO, INC. Docket No. 98-0555

Joint Application for approval of the reorganization of Illinois Bell Telephone Company d/b/a Ameritech Illinois, and the reorganization of Ameritech Illinois Metro, Inc. in accordance with Section 7-204 of The Public Utilities Act and for all other appropriate relief.

INITIAL BRIEF ON RE-OPENING OF THE PEOPLE OF THE STATE OF ILLINOIS, THE COOK COUNTY STATE'S ATTORNEY'S OFFICE AND THE CITIZEN'S UTILITY BOARD

JIM RYAN
Illinois Attorney General

EDWARD WASHINGTON, II
Chief, Public Interest Bureau
JANICE A. DALE
MATTHEW L. HARVEY
Assistant Attorneys General

Public Utilities Bureau
100 W. Randolph St., 12 Floor
Chicago, Illinois 60601
(312) 814-3736

RICHARD A. DEVINE
State's Attorney of Cook County

ADAM BOTTNER
Supervisor
ALLAN GOLDENBERG
DAVID L. HEATON
Assistant State's Attorneys

Environment and Energy Division
69 West Washington Street, Suite 700
Chicago, Illinois 60602
(312) 603-8600

CITIZENS UTILITY BOARD
ROBERT KELTER
208 S. LaSalle, Suite 1760
Chicago, Illinois 60604
(312) 263-4282

July 28, 1999

ORAL ARGUMENT REQUESTED

TABLE OF CONTENTS

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

SBC COMMUNICATIONS INC.,
SBC DELAWARE INC.
AMERITECH CORPORATION,
ILLINOIS BELL TELEPHONE COMPANY
d/b/a AMERITECH ILLINOIS, and
AMERITECH ILLINOIS METRO, INC. Docket No. 98-0555

Joint Application for approval of the
reorganization of Illinois Bell Telephone
Company d/b/a Ameritech Illinois, and the
reorganization of Ameritech Illinois Metro, Inc.
in accordance with Section 7-204 of
The Public Utilities Act and for all other
appropriate relief.

INITIAL BRIEF ON REOPENING OF THE PEOPLE OF THE STATE OF ILLINOIS, THE COOK COUNTY STATE'S ATTORNEY'S OFFICE AND THE CITIZEN'S UTILITY BOARD

The People of the State of Illinois, *ex. rel.* JIM RYAN, People of Cook County ("Cook County") *ex rel.* RICHARD A. DEVINE, State's Attorney of Cook County, and the CITIZENS UTILITY BOARD, by Robert Kelter, one of its Attorneys, hereby file this Initial Brief on re-opening pursuant to the Section 200.800 of the Rules of Practice of the Illinois Commerce Commission ("ICC" or "the Commission"). 83 Ill. Admin. Code Section 200.800.

This brief addresses some of the issues raised by SBC's and Ameritech's ("Joint Applicants") Joint Application for approval of the reorganization of Illinois Bell Telephone. This brief examines some of the questions raised by the Chairman of the Commission in a series of letters to the Hearing Examiners as the questions relate to the Joint Applicants' proposed acquisition of Ameritech Illinois. The brief also corrects the savings calculation

advocated by the People of the State of Illinois's Office, the Cook County State's Attorney's Office and the Citizens Utility Board in this docket.

I. SUMMARY OF THE PEOPLE OF THE STATE OF ILLINOIS, THE COOK COUNTY STATE'S ATTORNEY'S OFFICE'S AND THE CITIZENS UTILITIES BOARD'S POSITION ON THE ISSUES ON RE-OPENING

The Joint Applicants must satisfy all requirements of Section 7-204 of the Public Utilities Act in order for this reorganization to be approved. As we argued in our respective briefs, the record adduced prior to reopening failed to support approval of the Joint Applicants' proposed reorganization pursuant to Section 7-204. The Commission, in an effort to obtain more detailed information from the Joint Applicant's regarding their proposed reorganization, re-opened the record and sought further evidence, posing specific questions on a variety of issues. The Joint Applicants responded to these specific questions and submitted evidence in support of those responses.

The Joint Applicants' responses to several of these questions have proven to be wholly inadequate. This brief addresses Joint Applicants' testimony with respect to Commission questions regarding merger savings, competition, the merger's effect on retail rates and the enforcement of possible conditions to the merger.[1]

Based on the additional evidence presented during this reopened proceeding, the Joint

[1] Our focus on these areas should not be interpreted to mean that we believe the Joint Applicants have met their statutory burden on every other provision of Section 7-204. We refer the Commission to our briefs in the first phase of this proceeding where GCI's positions on all subsections of 7-204 are thoroughly addressed.

Applicants have once again failed to meet their statutory burden under Section 7-204. However, if the Commission decides the evidence presented on reopening legally justifies approval of the merger, the Commission must impose conditions specifically designed to eliminate or mitigate the risks and adverse competitive impacts of this reorganization in order to protect the public interest. Additionally, the Commission must equitably allocate merger-related savings to noncompetitive ratepayers consistent with Section 7-204(c).

With respect to the Commission's request that the parties craft specific conditions to address their concerns, the People of the State of Illinois, the Cook County State's Attorney's Office and the Citizens Utility Board stand by the conditions expressed in their respective briefs and exceptions filed in the initial phase of this docket.

II. ARGUMENT

The discussion that follows addresses Questions 1, 8, 9, and 12, as set forth in the Commission's June 4th letter to the Hearing Examiners, and as supplemented in their June 15th and July 9th letters.

A **<u>SAVINGS</u>: QUESTION NO. 8: Provide a total and complete breakdown detailing the Joint Applicants' estimates of the costs and savings associated with this merger. Explain methodology and assumptions used to arrive at the estimates for overall Ameritech savings, Ameritech Illinois savings, and SBC savings. Explain how these savings are spread between the Ameritech states. Explain the methodology and assumptions used to arrive at the estimates for overall Ameritech costs, Ameritech Illinois costs, and SBC costs. Explain methodology used to calculate the total estimated costs of this merger, including a breakdown of the component figures which add up to total estimate of costs.**

The record demonstrates that the Joint Applicants have not adequately responded to the Commission's concerns expressed in Question 8. The Commission requested "a total and

complete breakdown detailing the Joint Applicants' estimate of cost-savings associated with this merger," and then proceeded to itemize the specific points of clarification it requested with respect to the calculation of merger savings and costs, and the apportionment of those savings and costs among SBC, affiliates of Ameritech Corporation, and Ameritech Illinois.[2]

The fact that the Commission posed this question underscores the Commission's concern that Joint Applicants' prior testimony was lacking in sufficient detail on the method Joint Applicants used for assigning savings and costs to the various post-merger entities. Applicants make no effort to provide any new information regarding the breakdown of savings other than to put old information on a chart (SBC-Ameritech Ex.3.3 Schedule 1).

As Dr. Selwyn stated in his testimony:

> [The Commission's Letter] notwithstanding, neither Mr. Kahan nor Mr. Gebhardt have supplied additional details or new supporting workpapers to assist in clarifying this issue; rather, these witnesses have simply reiterated the discussion contained in their direct testimony. They even failed to respond to clarifying data requests from the ICC Staff by announcing "SBC reiterates that it has not evaluated merger savings on a state-specific basis for any state."

GCI Ex. 1.2 at 6 (Selwyn Direct Testimony on Reopening) *footnote omitted*. Similarly, Staff Witness Marshall states, "In my opinion, no additional data regarding savings has been provided in response to the Commission's request." ICC Staff Ex. 1.02. Thus even though Joint Applicants asked the Commission to allow them to amend their Application and to reopen the proceeding, Joint Applicants effectively avoided answering the very concerns upon which the Commission sought additional information, and which was the basis for the Commission

[2] See Question (8) in Attachment A to Chairman Richard Mathias' letter of June 4, 1999 to Hearing Examiners Mark Goldstein and Eve Moran.

granting Joint Applicants' request. In response to the Chairman's question 8, Mr. Kahan states:

> While not all of that information was put into the record by any party, Joint Applicants provided the information requested by the Commission to all parties as part of Joint Applicants' work papers. In order to ensure that another useful piece of this information is part of the record that the Commissioners can review and rely upon, I am including as Attachment 3 to this record a Confidential and Proprietary spreadsheet that shows the actual calculation of merger savings used by Joint Applicants in this case.
>
> Finally, Mr. Gebhardt is providing in his Direct Testimony on Re-opening an expanded explanation of how Joint Applicants estimated merger savings attributable to regulated, intrastate services.

SBC-Ameritech Ex. 1.3 at 17.

Mr. Kahan's assessment that the Joint Applicants already provided the information the Commission seeks is disingenuous. When the Commission took the unprecedented step of re-opening this proceeding that has been going on for eleven months in order to obtain this information, it obviously did not agree with Mr. Kahan's dismissive assessment. Further, Mr. Kahan's suggestion that the answers could be found in the Joint Applicants' "workpapers" but that no party introduced "*all* of that information" into the record misses the point. Joint Applicants' "work papers" and discovery responses consisted of several thousand pages of documents. Mr. Kahan ignores the fact that the *Joint Applicants*, not the intervenors, have the burden to provide the Commission with the necessary information and explanations on which to render a legally sustainable decision.

Additionally, Mr. Kahan points to Mr. Gebhardt, claiming that Mr. Gebhardt provides a "more expansive" explanation of how Joint Applicants estimated merger savings. SBC-Ameritech Ex. 1.3 at 17. However, Mr. Gebhardt admitted Ameritech simply relied on the numbers provided by *SBC* in the calculation:

> Q: As I understand it, your savings calculations are based on overall savings and cost estimates provided to you by SBC?
>
> A: That's correct.[3]
>
> . . . . . .
>
> Q: Now, did you have any participation in putting together the fundamental starting numbers that we have just been talking about concerning savings?
>
> A: No.
>
> Q: Did you do any independent verification of those numbers?
>
> A: I looked at it and noticed and noted that the proportion of the savings between — that were identified was that the larger proportion was allocated to Ameritech than the SBC states. Beyond that, <u>I didn't do any independent analysis</u>.

Tr. 2100-2101 (emphasis added)

While the Joint Applicants respond to the Commission's question with a reiteration of their original savings analysis, they are forced to admit that they have not provided the Commission with further information or provided the state-specific additional explanations about savings that the Commission pointedly requested. On cross examination, Mr. Kahan responded to a question about whether the Joint Applicants provided further information or analysis about Illinois-specific savings, stating: "We did no analysis at the Illinois level. There was no reason for us to, okay." Tr. 2047. However, when questioned on this issue,

[3] Tr. 2098.

Mr. Kahan responded:

> Q: In California you brought in, I believe, an outside firm to look at your numbers. Did you do that here?
>
> A: No. The Commission — no, we didn't. We didn't.

Tr. 2049, 2050. Clearly, the Commission's question *required* the Joint Applicants to provide the Commission with *further* analysis, even if it had not been originally performed. Joint Applicants declined to do so. Mr. Kahan admitted that Joint Applicants did not even have Mr. Kaplan, their point man on synergies and savings estimates, attempt to provide a more state-specific analysis. Tr. 2049. They declined despite the fact that the Commission asked them to provide precisely such information. Similarly, Mr. Gebhardt also admitted that Joint Applicants made no attempt in the re-opened proceedings to provide the Commission with additional information on savings:

> Q: Now, has Ameritech done any new calculations, made any new breakdown, come up with any new estimates, added any additional methodologies or refined any assumptions between when you first presented your testimony many months ago for the first time and the present?
>
> A: No. It's my understanding there are no calculations to be done.
>
> Q: Well, now, in fact, your testimony in the rebuttal reopening at page ten, pages ten and eleven, I think, says that more specific estimates, you say, simply do not exist.
>
> A: Correct.
>
> Q: What efforts were made either by Ameritech or SBC in the last month to obtain more specific estimates?
>
> A: They could not be obtained.

Q: Why not?

A: Because there is no way to do it without the companies actually sitting down and figuring out where these savings are going to occur.

Tr. 2104.

Given the above exchange, the Commission is more likely to figure out "who's on first?" than how the Joint Applicants arrived at their meager $31 million in savings allocable to Ameritech Illinois regulated services, much less how they justify it.[4]

[4] Indeed, in view of the Commission's expressed desire to obtain more information on the allocation of savings to Ameritech Illinois customers, GCI attempted to elicit a clearer, more detailed explanation of the methodology which Ameritech used to make its specific savings allocation to Illinois in his Direct Testimony on Reopening. GCI 1.2 at 12, footnote 20. Ameritech witness Gebhardt's responses during cross-examination led to Ameritech providing additional information regarding allocation among the five Ameritech operating companies. This data request response (GCI Ex. 1.3) became the basis for GCI Ex. 1.4. GCI Ex. 1.4 compares the savings allocation factors used for the Ameritech states with other factors which are directly related to Ameritech Illinois' share of network access lines and corporate expenses, among other factors. At the present time, the Hearing Examiners have limited the extent to which this exhibit can be used as evidence. That ruling is currently pending the Commission's decision on interlocutory appeal. See, *Petition for Interlocutory Review*, filed July 16, 1999, by the People of the State of Illinois, Cook County State's Attorney's Office and Citizens Utility Board.

Had the Joint Applicants provided the Commission with the state-specific information they sought in their June 4th letter, the Commission could have made an independent determination of what amounts should be included in a calculation of merger savings under Section 7-204(c). Therefore, the Joint Applicants have not met their burden of proof on the savings issue and the Commission must reject their approach.

Applicants Fail to Adequately Consider Savings Beyond 3 Years

Since savings from the merger will continue to accrue indefinitely beyond the first three years of the merger, a proper analysis of merger savings should focus on long-term savings to Illinois ratepayers. Indeed, the Commission's Question No. 8 asks the Joint Applicants to explain how they arrived at "overall Ameritech savings, Ameritech Illinois savings and SBC savings." (emphasis added) But the Joint Applicants' calculation only considers savings in the initial three years following approval of the proposed merger. GCI Ex. 1.2 at 8. The Joint Applicants suggest that after the first three years, all of Ameritech Illinois services will be competitive, and that no explicit flow-through will be required.

Such a sweeping prediction does not withstand scrutiny. On cross examination, Mr. Gebhardt admitted there was no evidence or documentation to support his assertion that the market would be competitive in three years:

> Q: What specific information do you have, what study have you done, what documents are there that we could look at to verify or test your assertion that this marketplace, Ameritech Illinois' marketplace is likely to be competitive in three years?
>
> A: I don't have a study that I can show you. I have a lot of experience in this business. . . .

Tr. 2110. Mr. Gebhardt's experience notwithstanding, given the lack of effective local

competition in the Illinois market today, it is extremely unlikely that competition sufficient to justify such deregulation will have developed in so short a period, if indeed it *ever* develops. GCI Ex. 1.2 at 8.

Since any projection as to the extent of local competition at any given point in the future is at best highly speculative, the Commission should clearly adopt a policy, such as Dr. Selwyn's ten year recommendation to flow through estimated savings, that is reversible in the event that market conditions actually change from those extant at the present time. GCI Ex. 1.2 at 15, 23. As Dr. Selwyn discussed in his direct testimony, the Commission can, and should, periodically revisit the annual merger-related rate adjustments.[5] However, were the Commission to accept the highly truncated flow-through being offered by Joint Applicants, and if effective price constraining competition fails to develop at the end of the initial three-year period, the Commission will likely encounter extreme difficulty in assuring that Illinois consumers realize any merger savings. Id.

The Commission Should Adopt Dr. Selwyn's Approach to Calculating the Savings and Utilize Staff's Approach to Flowing Through the Savings to Ratepayers.

The Commission should adopt the approach described by Dr. Selwyn in his testimony recommending that a one-time rate reduction of $ 471,584,762 should be flowed through to customers of Illinois Bell's non competitive services, to remain in place for a period of ten years. GCI Exhibit 1.2 at 15-17 (Selwyn).[6] Should the Commission choose not to adopt such

[5] GCI Ex. 1.0 at 92 (Selwyn Direct).

[6] Selwyn's direct testimony on re-opening corrects an error that he made in his original calculation. The effect of this error was to understate the Illinois allocation of total merger savings. GCI Ex. 1.2 at 10 (Selwyn).

an allocation, it can utilize its discretion and allocate 50% of savings to ratepayers resulting in a one-time rate reduction of $235,792,381 million, to remain in place for ten years. See GCI Ex. 1.2 at 19.[7]

[7] Although Dr. Selwyn's testimony stated that a 50%/50% merger savings allocation was proposed by CIPS in the CIPSCO/Union Electric merger proceeding, a 65%/35% allocation was eventually proposed.

The approaches taken by Ms. Toppozada-Yow and Dr. Selwyn are sound approaches based on good public policy. If the Commission disagrees with Dr. Selwyn's approach, the Commission should explore alternatives that would result in Illinois consumers being given the allocation of savings required by statute. It would be unfair for shareholders to know up front what they will gain by the transaction and for consumers to have to wait. As Mr. Kahan conceded, tracking actual merger savings becomes more difficult the further away from the date the merger occurs. Tr. 513. Beyond the question of fairness, Illinois law requires the Commission to rule on the allocation of any savings resulting from the proposed reorganization.[8]

B. COMPETITION: QUESTION NO. 1: An explanation of whether SBC is or is not an "actual potential competitor" in Illinois, as the term has been used throughout this proceeding.

The Joint Applicants maintain on re-opening, see e.g. SBC-Ameritech Ex. 1.3 at 3 (Kahan) as they have maintained since their post-hearing briefs that SBC had no plans to enter the Illinois wireline market. While it is admittedly difficult to prove a "negative," as they contend, the Joint Applicants do not specifically address the factors that would give SBC a tremendous advantage in providing facilities-based local telephone service. These factors, discussed below, include the marketing advantage SBC has gained from providing cellular

[8] For a detailed listing of the amounts in Dr. Selwyn's calculation, Table 3 of his direct testimony on re-opening is attached to this brief. GCI Exhibit 1.2 at 17 (Selwyn).

service in Illinois and local wireline service near St. Louis, and the experience and resources SBC brings to local exchange service as one of the largest and most successful RBOCs.

SBC is an "actual potential competitor" if the company is able to enter local exchange markets in the Ameritech region without the benefit of the SBC/Ameritech merger. In the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, Cross Ex. 36 at 26 three criteria are used to evaluate whether a competitor could enter a market. According to DOJ, entry is "easy" if it would be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern". If a company can enter a market with sufficient "ease", then it is an actual potential competitor. While these guidelines can provide a useful framework for analyzing competition, they must be considered in the context of the applicable standard set out in the Public UtilitiesAct in Section 7-204(b)(6).

The weight of the evidence in this case leads to the inevitable conclusion that SBC is an actual potential competitor in the local exchange market. SBC's desire to become a national and international provider of telecommunications services, GCI Ex. 1.0 at 17-18, requires that SBC enter the Chicago area market.

The Fact that SBC Has Available Feasible Means for Entering the Market Makes SBC a Likely Competitor

The likelihood that SBC would be an actual potential competitor requires that SBC have available feasible means for entering the market other than through acquisition of the market's dominant firm. Some federal courts require "clear proof" of entry, while others only require a "reasonable probability", see e.g. FTC v. Atlantic Richfield Co., 549 F.2d 289, 294-

295(4th Cir 1977); BOC International Ltd. v. FTC, 557 F.2d 24, 28 (2nd Cir. 1977); Mercantile Tx. Corp. v. Board of Governors, 638 F.2d 1255, 1268-1269 (5th Cir. 1981). While SBC denies that it is an actual potential competitor, it is in fact the company most likely to compete for local exchange in this market if the merger is denied, because of the company's size (third largest local exchange carrier), financial strength, cellular presence in the Chicago area, and experience in providing local exchange service in its own region as well as the Illinois portion of the St. Louis MSA.

Any telecommunications company with national and international ambitions could not avoid competing for providing local exchange service to the extensive network of national and multinational corporations with offices in the Chicago MSA, GCI Ex. 1.0 at 27 ; ICC Staff Ex. 4.01 at 7. SBC has previously admitted it has sufficient financial resources to enter the Chicago MSA independently. A large company such as SBC can incur substantial losses to initiate its national-local strategy and build market share with large business customers. The attractiveness and potential profits of the Chicago MSA is shown by the number of CLECs who have attempted to offer local exchange services here.

GCI also notes that witness Kahan's testimony regarding SBC's future plans should be discounted given the objective business realities facing SBC. Witness Kahan states, "parties must recognize that a substantial market entry cannot be mounted without substantial corporate planning, including documented strategies, business cases and supporting budgets." Mr. Kahan makes this statement to support his contention that SBC has no plans to enter the market. Yet, when it comes to making significant business decisions, Joint Applicants have demonstrated the ability to change positions quite quickly. Throughout this proceeding

Applicants committed not to seek local exchange certification for their national/local subsidiary in Illinois until January 1, 2001. SBC-Ameritech Ex. 1.3 at 22. Then in Mr. Kahan's Rebuttal Testimony on Re-opening the Applicants change the date to January 1, 2003. On cross-examination Mr. Kahan stated that the Applicants made this decision in "like a day." Tr. at 1971. While the decision to delay local exchange certification for the national/local subsidiary may not be of the exact same magnitude of SBC's entry into Ameritech's market, it is significant enough to raise questions regarding exactly what long range plans SBC truly has.

The Record Indicates SBC Current and Future Business Plans Are Consistent with the Criteria for Timeliness

The definition of timeliness in this context is not precise. The California Commission has said that "actual potential competitor is a firm that does not currently compete in the relevant market but would enter sometime in the *near future*"…, 1991 Cal. PUC Lexis 629, 177 PUB 462. Some federal courts require a "reasonable time", BOC International, 557 F.2d at 29. The time necessary for entry may be extended if the market is such that the new firm's pro-competitive efforts will be required.

SBC's "national-local" plans are not purely speculative. For example, SBC already owns interests in OnePoint which currently competes with Ameritech in the Chicago area for residential customers in multi-dwelling units. Tr. 2040. While OnePoint's market share is small, subscriber growth rate is 22% per quarter. Staff Ex. 4.02. Similarly, in the data communications market SBC has established a business relationships with Concentric Communications and Williams Communications. Tr. 2040; 2052-2053. Williams owns a

national fiber-optic network which currently serves Chicago, and Concentric is a leader in internet-based business data service technology. Staff witness Graves concludes that these alliances further demonstrate SBC's commitment to compete in Illinois if the merger is not approved. ICC Staff Ex. 4.02 at 11-13. SBC has previously been awarded certificates by the ICC to provide local service in Illinois, and has been active in the Chicago MSA market for nine years. It is likely that the condition of significant monopoly in local service will continue for many years, so that SBC's independent competitive efforts will always be required (and desired).

SBC Would Enter the Chicago MSA Market To a Sufficient Extent to Qualify as an Actual Potential Competitor

A "sufficient" actual potential competitor would eventually service both business and residential customers in local exchange, and only the RBOCs, with specific experience in the local telephone business, can provide facilities based service to compete with other RBOCs. Other providers, such as AT&T, MCI and Sprint, will continue to compete in the business markets, particularly in long distance as they currently do, but are not positioned to provide local service because they do not currently provide any substantial local exchange service in the United States. Only the RBOCs, and specifically SBC, have the means to provide the one-stop shopping for telecommunication services that business and residential customers desire, as SBCs own corporate literature has emphasized, GCI Ex. 1.0 at pp. 15-29, ICC Staff Ex. 9.00 at pp. 20-26.

In addition SBC has a significant advantage over other non-RBOCs in marketing vertical services such as Caller I.D. and Call Waiting. SBC has the dominant market share in

its current region, and is rapidly increasing its penetration rate in California markets, SBC-Ameritech Ex. 1.1 at 26, ICC Staff Ex. 4.00 at 37, SBC 1997 Annual Report at 12. As Staff has pointed out in its initial brief, SBC could use these services and its marketing abilities to compete with Ameritech Illinois for local services.

The U.S. Supreme Court has held that economic factors are to be considered when the court is evaluating a likely new competitor, U.S. v. Falstaff Brewing Corp., 410 U.S. 526, 533 (1973). Despite SBC's assertions that the company would not enter the Chicago MSA without a merger with Ameritech, this Commission should use the objective evidence presented by GCI and Staff and cited above rather than subjective assertions of the Joint Applicants and conclude that SBC is an actual potential competitor in the Ameritech Illinois market.

> **C. NATIONAL LOCAL SUBSIDIARY: QUESTION NO. 9:** A clear explanation of the National Local Subsidiary, as used in this docket, and the impact that this subsidiary would have on retail rates. Explain what happens to AI's retail rates should the applicants transfer the top-revenue customers to this subsidiary for telecommunications services. Explain what the revenue impact would be for Ameritech Illinois if the top customers are shifted to the National Local Subsidiary. Explain if the National Local Subsidiary would provide local service for its customers in Illinois. Explain whether the National Local Subsidiary would be certified as a CLEC in Illinois. Explain whether the National Local Subsidiary would be treated as any other CLEC would be treated in its interactions with AI.[9]

[9] Chairman Mathias' letter dated June 4, 1999, question 9.

In response to the Commission's above question, the Joint Applicants have made a commitment to not seek local exchange certification of any subsidiary intended to implement the National-Local Strategy until January 1, 2003. Joint Applicants' Ex. No. 1.5 at 9. They further state that such a subsidiary will not operate in Illinois "for the foreseeable future." SBC-Ameritech Ex.1.3 at 18. Mr. Kahan further "confirms" his "expectation" that the Joint Applicants will implement the National-Local Strategy in-region through the use of cooperative agreements, somewhat in the nature of subcontractor agreements, pursuant to which the National-Local subsidiary would purchase services from the incumbent LEC in-region at tariffed rates. Id., at 18-19. The Joint Applicants "do[] not presently intend to pursue [the National Local strategy through a CLEC subsidiary] in Illinois." Id., at 22. Even if they elect to do so, a contingency for which they leave the door open, Id., at 22, the Joint Applicants assert that they will be governed by affiliated interest and non-discrimination rules[10], and that the Commission will retain its right to regulate local service tariffs. Id., at 21-22, SBC-Ameritech Ex. 1.5 at 16. This, the Joint Applicants aver, means that the National-Local Strategy will have no impact on Ameritech Illinois' operations or retail rates. SBC-Ameritech Ex. 1.3 at 18.

[10] Mr. Kahan would not go so far as to state that the National-Local subsidiary could not receive preferential treatment from Ameritech or SBC. Rather, he professed to no knowledge regarding this point. Tr. 1920.

The Joint Applicants, however, leave many questions unanswered. Mr. Kahan's expectations, whether "confirmed" or not, do not amount to a commitment of any sort on behalf of the Joint Applicants. The commitment which the Joint Applicants are willing to make is that they will not seek certification of a National-Local subsidiary in Illinois earlier than January 1, 2003. SBC-Ameritech Ex. 1.5 at 9. Since Mr. Kahan has testified that the National-Local strategy will take ten years to implement, Tr. 296, and that the strategy will lose money for at least several years, Tr. 464-65, 468, Joint Applicants' forbearance from seeking certification of a National-Local Subsidiary in Illinois for about three years is somewhat less than impressive. Further, every other representation made by the Joint Applicants in this regard is either a statement by Mr. Kahan of the Joint Applicants' present intentions, which they do not commit to for the reason that those intentions may change[11]; or an assurance that regulators can prevent certain egregious practices by the Joint Applicants if such practices can be detected.

All of this lends weight to Dr. Selwyn's opinion that the National-Local Strategy will

[11] As previously noted, Joint Applicants' plans *have* changed since the reopening of this docket; initially, the Joint Applicants committed to forbear from seeking certification of a National-Local subsidiary until January 1, 2001. Joint Applicants' Exhibit No. 1.3 at 21-22. Moreover, Mr. Kahan's knowledge regarding the likely activities of the National-Local subsidiary is perhaps less than might be wished. He does not know whether the subsidiary will provide advanced services, Tr. 1946, nor whether the subsidiary will provide long distance. Tr. 1947.

indeed put upward pressure on rates, or divert lucrative business customers to the National-Local subsidiary. GCI Exhibit No. 1.2 at 26. It is clear, as Mr. Kahan testifies, there is greater competition in business market than residential / consumer markets. Tr. 460.

Thus, the Fortune 500 business customers which the National-Local strategy seeks to court, *see* Tr. 281-282, will have significantly greater choice regarding selection of carriers, and that the market for such customers will have to respond through actual competitive prices. As Dr. Selwyn observes, the National-Local subsidiary will very likely need to adopt a national pricing / volume discount structure, sacrificing Ameritech Illinois revenues from such customers. GCI Exhibit No. 1.2 at 26. The Joint Applicants will not have the luxury, as Ameritech currently has with small business and residential customers, of *increasing* rates after declaring a service competitive. GCI Exhibit No. 1.2 at 29. The Fortune 500 customers the Joint Applicants seek to obtain through the National-Local Strategy will not tolerate such conduct; having actual competitive choices, they will avail themselves of them. Thus, Ameritech Illinois is likely to, as in the past, declare additional services and rates competitive, and increase them, in this case to make good lost revenues from discounted service offerings to National-Local Strategy customers. Id.

Contrary to Applicants assertions, the Alternative Regulation Plan offers no protection against this. GCI Exhibit No. 1.2 at 30-31. Ameritech can raise competitive rates on one day's notice, Tr. 2090, 2092, and, as has been seen, where Ameritech is alleged to have improperly declared a service competitive, Commission enforcement action takes a great deal of time. Tr. 2091-92. Thus, Mr. Kahan's representation that Commission enforcement will solve such problems is hollow.

D. <u>ENFORCEMENT</u>: QUESTION 12: Reasonable and effective enforcement mechanisms for any condition imposed, including appropriate penalties, economic or otherwise;

The Commission's June 4th letter to the Hearing Examiners included a broad request for information from the Joint Applicants regarding enforcement of merger-related conditions. The Joint Applicants responded with a series of enforcement commitments, including the appointment of a corporate officer to oversee implementation of, and compliance with merger commitments, to be overseen by an audit committee of SBC/Ameritech's Board of Directors. Within 6 months following the merger closing, and annually thereafter, Joint Applicants offer to file with the Commission a report detailing its compliance with its merger commitments. Additionally, Joint Applicants have proposed to hire, at their own expense, independent auditors to verify SBC/Ameritech's compliance through compliance reviews, to be issued 1 year after the merger closing and for three years after the merger closing. Both the compliance report and the auditors' review would be filed with the Commission for the public record.

Direct testimony filed by SBC witness Kahan on reopening stated that the compliance officer, by reporting directly to the audit committee of SBC/Ameritech's Board of Directors, will have "the ability to impact corporate policies, actions and spending in a direct and immediate manner." Kahan maintained that the existence of a compliance officer with such authority would facilitate the Commission's ability to seek and receive responses on all issues regarding the Joint Applicants compliance with Commission obligations. SBC-Ameritech Ex. 1.3 at 23.

In its June 15th letter to the Hearing Examiners, (Attachment A-1, Item 12) the

Commission sought to clarify its first request for evidence on compliance verification and the enforcement of conditions, as contained in Item No. 11 of the June 4th letter:

> 6) For any and all proposed commitments made by the Applicants throughout their June 10, 1999 filing, what are the specific enforcement mechanisms which would be used by the Commission in the event of non-compliance with such commitments?

The Joint Applicants responded:

> Joint Applicants have attempted to address the specific enforcement mechanisms appropriate to specific commitments throughout their testimony. In addition to the stated mechanisms, the Commission retains full authority over Joint Applicants to investigate and/or conduct hearings on any complaints about non-compliance. In addition to its statutory enforcement mechanisms, the Post Exceptions Proposed Order identified an additional penalty/incentive mechanism to ensure Joint Applicants full compliance with the commitments they have made in this docket, i.e., an increase in the savings allocation flowed through to Illinois ratepayers.

SBC witness Kahan's supplemental direct testimony on reopening, filed in support of the above answer, does not refer to any specific "enforcement mechanisms," but as is the case with so many other issues in this proceeding, relies upon the Commission's existing general enforcement authority under the Public Utilities Act. It also refers to the two-tier savings allocation methodology that was included in the Hearing Examiners' Post Exceptions Proposed Order as further incentive. SBC-Ameritech Ex. 1.4 at 9.

First, it should be noted that any savings which may flow through to ratepayers under Section 7-204(c) constitute an independent entitlement. Savings allocations must be made under Section 7-204(c) regardless of a utility's performance or commitments on other issues and should not be used as a means to enforce compliance with valid Commission orders.

Secondly, the Commission should view these pledges in light of the poor track records which both SBC and Ameritech have compiled on commitments made to regulatory agencies in exchange for some desired relief. GCI witness Selwyn explained that recent commitments made by SBC in Connecticut and Ameritech in Indiana to the respective public utility commissions in those states had either not been fulfilled or were the subject of attempted modifications soon after the utility made them. GCI Ex. 1.2 at 32-33. Specifically, Selwyn presented a recently filed request made by SBC to the Connecticut Department of Public Utility Control, in which SBC's cable affiliate asks that they be permitted to modify their statewide cable franchise obligation, an SBC commitment originally made to the DPUC in connection with SBC's acquisition of Southern New England Telephone Corporation. Through the Application, SBC 's cable affiliate, SNET Personal Vision ("SPV"), seeks to reduce its facility deployment from the statewide commitment they originally made to provide cable service to 169 towns to only the 26 towns it currently serves or will soon serve in the near future, while it studies "alternative technologies." GCI Ex. 1.2, Appendix 3, p. 2. *Evaluation and Application to Modify Franchise Agreement by SBC Communications, Inc., Southern New England Telecommunications Corporation, and SNET Personal Vision, Inc.*, filed April 1, 1999, Docket No. 99-04-02.

The Commission should be aware that SBC maintains a rather liberal view of the term "commitment." Remarkably, SBC's position appears to be that in spite of having made a drastic proposal to delay a service commitment to 143 communities, they have not reneged on their agreement with the Connecticut DPUC. In fact, under cross-examination, SBC witness Kahan claimed that the Application, which specifically requests modification of Section 3 of its

cable affiliate's franchise agreement (and is even entitled "Application to Modify Franchise Agreement"), was not actually a request for modification. Tr. 2035. The Commission is well-advised to note that SBC's long-term "commitments" could prove to be amazingly short-lived.

According to Selwyn, Ameritech, too, has fallen short of recent regulatory commitments. Comments filed by the Indiana Utility Regulatory Commission with the Federal Communications Commission and introduced by GCI into the instant record, reported that Ameritech Indiana had fallen far short of a 6-year commitment -- made in connection with its alternative regulatory plan -- to spend $20 million annually to connect schools, hospitals and government centers to a two-way learning network. The IURC's review of Ameritech Indiana's expenditures revealed that the company was delinquent in its commitment and that Ameritech had included investments in retail stores, an amusement part, an industrial plant and a hotel in its accounting of expenditures that were meant for public institutions. GCI Ex. 1.2 at 34-35.

It should also be noted that once again, the Joint Applicants failed to answer the specific question posed by the Commission. The Commission's question addressed enforcement mechanisms "for any condition imposed." The Joint Applicants' response, however, refers only to "these commitments," presumably a reference not to Commission-mandated conditions, but to those commitments volunteered by the Joint Applicants Hence it appears that the Joint Applicants' offer to file their own compliance report, as well as to engage an independent auditor to verify SBC-Ameritech compliance, pertains only to the Joint Applicants' voluntary commitments or to any and all conditions which the Commission may

impose in connection with the proposed merger, including but not limited to the voluntary commitments.

Given the Connecticut DPUC's experience with SBC's statewide cable franchise and the IPURC's recent experience with Ameritech Indiana's network infrastructure accounting, we believe that every effort should be made before the merger is approved to insure that the Commission and interested parties can obtain a complete and comprehensive accounting of Joint Applicants' compliance with every condition, voluntary or not, contained in this Commission's orders. In order to eliminate any ambiguity in this regard, we recommend that Joint Applicants be ordered to file compliance reports with respect to all conditions imposed by the Commission. The independent auditors, likewise, should address all conditions that are part of the Commission's approval of this merger.

The filing of both of these reports with the Commission should be public filings, with both made available on the Joint Applicants' Internet site. The material contained within these reports should not be presumed proprietary or confidential. Proprietary and/or confidential treatment may be sought only through a formal request to the Commission, to be filed 30 days prior to the filing of either report. Commission Staff and interested parties should also be provided with an opportunity to respond to the request for proprietary treatment, and the burden of proof shall be on the party proposing proprietary and/or confidential treatment. Opportunity to comment on each report, including the opportunity to present evidence, should be afforded to ICC Staff and interested parties. The Commission should also initiate official proceedings to formalize the results of the independent audit, issue findings on the audit results, and assign any penalties due to non-compliance.July 28, 1999

IV. CONCLUSION

WHEREFORE, the People of State of Illinois, the Cook County State's Attorney's Office and the Citizens Utility Board urge this Commission to conclude that given the additional evidence presented during this reopened proceeding, the Joint Applicants have once again failed to meet their statutory burden under Section 7-204 of the Illinois Public Utilities Act.

If the Commission decides the evidence presented on reopening legally justifies approval of the merger, the above-named parties respectfully request this Commission to impose conditions specifically designed to eliminate or mitigate the risks and adverse competitive and consumer impacts of this reorganization in order to protect the public interest, as described herein above and in the parties respective briefs.

Respectfully submitted,

JIM RYAN
Attorney General of Illinois

By:_____
Edward Washington, II
Chief, Public Interest Bureau
Janice A. Dale
Matthew L. Harvey
Assistant Attorney Generals
Public Utilities Bureau
100 W. Washington Street, 12 Floor
Chicago, Illinois 60601
(312) 814-3736

RICHARD A. DEVINE
State's Attorney of Cook County

By:_____
Adam Bottner
Supervisor
Allan Goldenberg
David L. Heaton
Mitchell Levin
Assistant State's Attorneys
Environment and Energy Division
69 West Washington Street, Suite 700
Chicago, Illinois 60602
(312) 603-8600

CITIZENS UTILITY BOARD

By:_____
Robert Kelter
One of its Attorneys
208 South LaSalle Street, Suite 1760
Chicago, Illinois 60604
(312) 263-4282

Dated: July 28, 1999